

CRISIL's criteria for loss given default ratings

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I. Background

Loss given default (LGD) is the likely loss or shortfall in recovery that a lender/ investor has to bear if there is a default on the credit exposure. While conventional ratings indicate the probability of default (PD, defined as a delay of even one day of even one rupee), an LGD rating represents CRISIL's independent opinion on the likely range of loss that a lender could be exposed to - as a percentage of its exposure – if there is a default. LGD depends on a variety of factors, including the fundamental viability of the entity, capital structure, scope for promoter funding, and the value of assets provided as security and collateral.

II. Scope

An LGD rating may be determined for all cases, including both stressed and standard assets.

III. LGD rating scale

An LGD rating is an independent opinion on the likely range of loss to be incurred by a lender - as a percentage of its exposure – if there is a default. An LGD rating is issue-specific as it factors in the seniority of claim on cash flow and presence of security (if any).

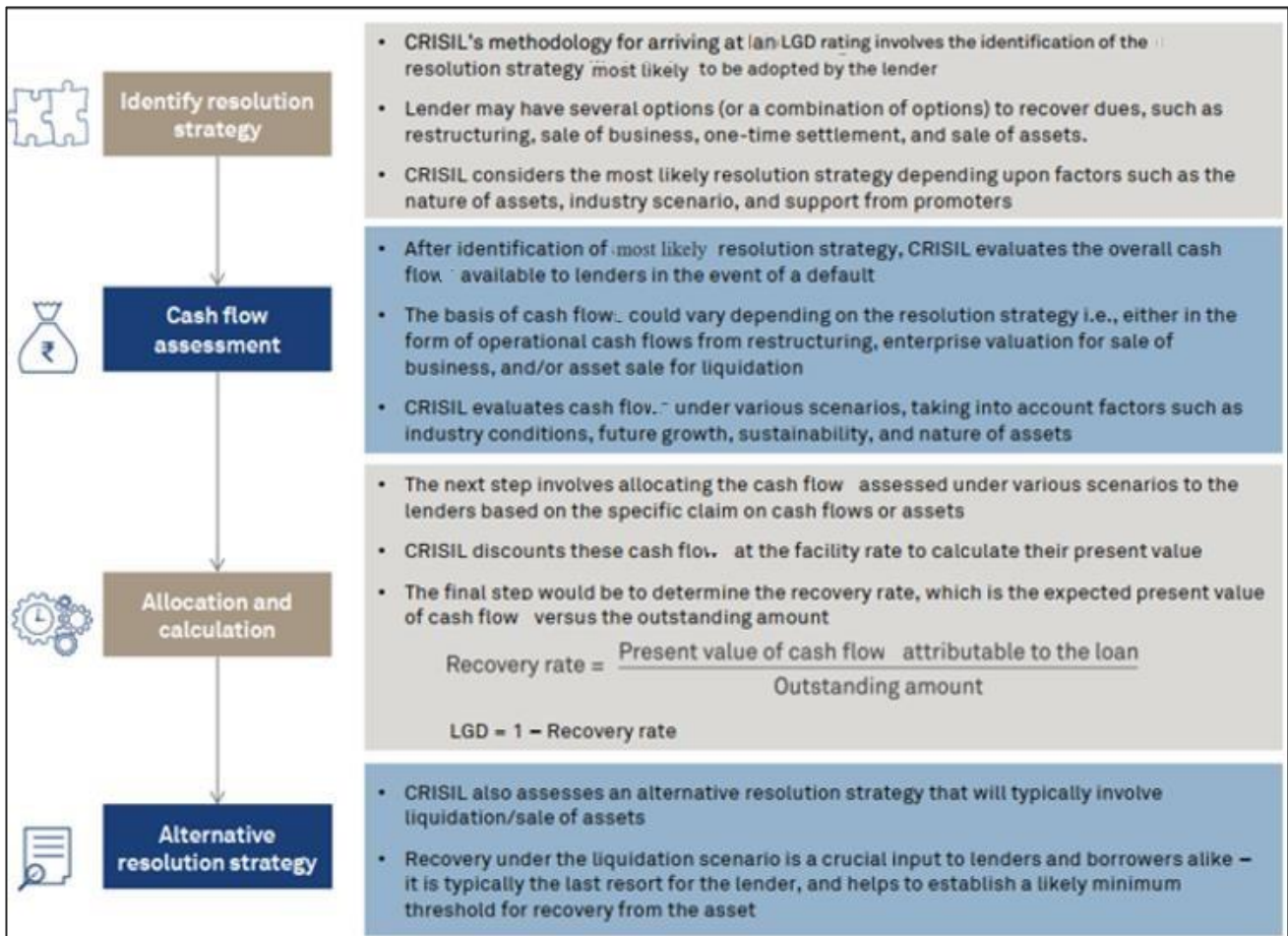
The LGD rating uses a 6-point scale, from LGD 1 to LGD 6, corresponding to the likely loss range

LGD rating	Likely loss range
LGD 1	0% - 15%
LGD 2	15% - 30%
LGD 3	30% - 45%
LGD 4	45% - 60%
LGD 5	60% - 75%
LGD 6	75% - 100%

IV. Methodology for computing LGD

CRISIL's methodology for computing LGD typically involves four steps:

1. Identify resolution strategy
2. Cash flow assessment
3. Allocation and calculation
4. Alternative resolution strategy



V. Conclusion

LGD ratings look at the amount that may not be recoverable in case of default. For this, CRISIL evaluates the most likely resolution strategy, typically based on the business existing as a going concern, and generating cash flow. As an alternative resolution strategy, estimated loss for other modes of recovery may also be evaluated. The LGD rating can be a useful tool to estimate the likely loss in the case of stressed assets. When combined with PD, LGD can also be useful in assessing the expected loss of standard assets, which is key to pricing of loans.

About CRISIL Limited

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It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

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